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Awaken the Dead: New Jersey Courts Should Revive the Duty to Defend

By Robert D. Chesler and Janine M. Stanisz

In the 1980s and 1990s, New Jersey earned a justified reputation as a pro-policyholder jurisdiction. In those highly contentious days of environmental insurance litigation, New Jersey courts ruled favorably for policyholders on many coverage issues. At the same time, however, on key issues affecting an insurance company's duty to defend, New Jersey is out of step with other states, disadvantaging the policyholder.

There's a High Flying Burd

Burd v. Sussex Mutual Insurance Co., 56 N.J. 383 (1970), is the bête noir for New Jersey policyholder counsel. *Burd* dealt with a common situation — a complaint accused the defendant of both negligent and intentional conduct. The defendant had insurance. The policyholder and the insurance company shared an interest in defeating the complaint. However, the theory was that an attorney appointed by an insurance company may have interests that conflict with the policyholder's — while the attorney represents the policyholder, that attorney receives his cases from the insurance company. Should the defendant be found liable, the insurance company is better off if the policyholder loses on the uncovered cause of action. In practically every state except New Jersey, in this situation, insurance companies must appoint independent counsel, also known as *Cumis* counsel, to defend the policyholder. Independent counsel is designed to avoid this potential conflict.

New Jersey alone chose a different path. In *Burd*, the New Jersey Supreme Court held that when a conflict exists, the policyholder's right to a defense becomes a right to reimbursement. In other words, the policyholder must defend itself and seek reimbursement of its attorney's fees if it wins. *Burd* is incredibly unfair. When a policyholder purchases a general liability policy, it is purchasing litigation insurance. It knows that if it is sued, the insurance company will step in, appoint counsel, and pay for the defense. Without this structure, the policyholder may not know how to locate experienced counsel, and may not have the disposable income to pay for the defense.

Please, Sir, I'd Like Some More

Many if not most complaints contain mixed allegations of covered and uncovered causes of action. In the majority of states, when there are mixed allegations, the insurance company must pay all of the policyholder's legal

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fees, subject to certain exceptions. In *SL Industries, Inc. v. American Motorists Insurance Co.*, 128 N.J. 188, 198-99 (1992), the New Jersey Supreme Court recognized that most courts do not require such apportionment for the defense of potentially covered claims and those that would not be covered. However, the New Jersey Supreme Court also held in *SL Industries* that these courts are wrong, and that allocation is usually possible. This position is unreasonable and in stark contrast to the reality of how cases are defended. As a result, policyholders in New Jersey are embroiled in difficult allocation proceedings and potentially recover only a portion of their fees.

The Appellate Division has examined the complexity of allocating attorneys' fees for covered and uncovered claims. In *Hebela v. Healthcare Insurance Co.*, 370 N.J. Super. 260, 274-75 (App. Div. 2004), the court identified three types of fees: 1) fees only incurred with respect to covered actions, which are the insurance company's responsibility; 2) fees incurred solely in support of uncovered causes of action, which are the policyholder's responsibility; and lastly, 3) mixed fees incurred with respect to both covered and uncovered causes of action. Acknowledging that mixed causes of action present more difficult allocation questions, the court quoted *SL Industries*, stating: "[w]hen defense costs cannot be apportioned, however, the insurer must assume the cost of the defense for both covered and non-covered claims."

Here's One For You, Nineteen For Me

A second allocation issue arises when the modified continuous trigger/pro rata approach formulated in *Owens-Illinois, Inc. v. United Insurance Co.*, 138 N.J. 437 (1994) and *Carter-Wallace, Inc. v. Admiral Insurance Co.*, 154 N.J. 312 (1998) is applied to attorneys' fees. See *Universal-Rundle Corp. v. Commercial Union Insurance Co.*, 319 N.J. Super. 223, 245-46 (App. Div. 1999) ("The [trial] judge's novel approach of making defendant pay only the costs of cleanup and remediation in excess of the settlements while obligating it to pay all defense costs is simply not a method suitably respectful of the *Owens-Illinois* and *Carter-Wallace* courts' directives that allocation be based on an insurer's time on the risk and degree of risk assumed."), certif. denied, 161 N.J. 149 (1999). Thus, under New Jersey law, if a policyholder receives an asbestos complaint alleging 40 years of exposure, the policyholder must locate 40 years of insurance policies before it can get full coverage for its attorneys' fees. Most policyholders do not retain insurance policies for more than a few years and are unable to locate old policies. Other states, Pennsylvania for example, do not require policyholders to locate all historical coverage in order to receive 100% defense.

Requiring the compilation of years' worth of policies is a nightmare for the ordinary policyholder. As discussed, when a policyholder receives a summons and complaint, it goes to its insurance company to be defended. Now, that insurance company can say, for example, I have only two years out of 40, chase your other insurers for the balance, or pay your own way.

The duty to defend is fundamentally different from the duty to indemnify, as the Supreme Court addressed in *Owens-Illinois* and *Carter-Wallace*. The duty to defend is triggered by a "suit." Nothing in the insurance policy allows the insurance company to pay only a share of defense costs. The policyholder should not have the burden of gathering 40 years of insurance policies and allocating defense costs among the insurance companies to each party's satisfaction, with each insurance company having the right to select counsel. Rather, any insurance company that may be "on the hook" should have the obligation to defend its policyholder in full.

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